In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 329

CHARLES P. HASBROOK and MARCIA B. HASBROOK,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioner Charles P. Hasbrook owned 598 of the 1,000 shares of voting common stock of Mt. Mansfield Television, Inc. (Mt. Mansfield), and 270 of its 1,000 shares of preferred stock. He also owned 98 of the 100 shares of common stock (all except two qualifying shares) of WCAX Radio, Inc. (WCAX). As of December 31, 1957, WCAX had never paid a dividend, and had earned surplus in excess of $28,000. (Pet. 12.)

Mt. Mansfield needed to raise $30,000 in 1957 in order to complete a new building it would occupy

jointly with WCAX. Mt. Mansfield's financial condition at that time was not good, and its credit was limited. WCAX, on the other hand, was doing well. (Pet. 12). In order to raise this $30,000 needed by Mt. Mansfield, petitioner did not simply pledge his WCAX stock as collateral for a bank loan and then turn the money over to Mt. Mansfield. Instead, he sold his 270 shares of Mt. Mansfield preferred to WCAX at his cost of $100 per share, and WCAX obtained the $27,000 purchase price by pledging both the 270 shares of Mt. Mansfield preferred stock and petitioner's unsecured note to a bank for a loan. (Pet. 12-13.) Petitioner then lent part of the $27,000 proceeds to Mt. Mansfield; others, including petitioner's stepson, loaned the additional amounts needed to make $30,000. (Pet. 13). Thereafter Mt. Mansfield repaid the amount petitioner had loaned it, and WCAX repaid the amount it had borrowed from the bank (Pet. 13). The net result of these transactions was thus that (1) WCAX transferred $27,000 cash to petitioner and (2) petitioner transferred 270 shares of Mt. Mansfield preferred stock to WCAX (which he still controlled through 98% stock ownership). Neither Mt. Mansfield nor WCAX contracted their business activities in any way, the $27,000 paid to taxpayer by WCAX was out of its earnings and profits, and there was no change in basic shareholder relationships. (Pet. 13.)[1]

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[1] During 1959, 1960, and 1961 Mt. Mansfield redeemed its preferred stock including those shares held by ~~Mt. Mansfield~~ WCAX (Pet. 13, 20). Had taxpayer still owned the Mt. Mansfield

Taxpayer did not include any of the $27,000 received from WCAX for his Mt. Mansfield preferred in his income (Pet. 20). The Commissioner determined that WCAX's $27,000 payment to petitioner constituted a distribution essentially equivalent to a dividend, and was thus taxable as ordinary income in 1957. After paying the resulting deficiency petitioner sued for a refund; the district court upheld the Commissioner's determination, and the court of appeals affirmed. (Pet. 11-24.)

Section 304(a)(1) of the Internal Revenue Code of 1954 (Appendix, *infra*, pp. 7-8) provides that when one or more persons are in control of each of two corporations, and one of the corporations purchases stock of the other from the controlling shareholder or shareholders, the transaction "shall be treated as a distribution in redemption of the stock of the corporation acquiring such stock." Thus, when WCAX acquired some of Mt. Mansfield's preferred stock from petitioner who controlled both corporations, WCAX was treated as redeeming its own stock. The purpose of this provision of the Code is to bring such transactions involving related corporations within the scope of Section 302 of the 1954 Code (see S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 239-240) which provides in part that if a corporate distribution made in redemption of stock is essentially equivalent to a dividend, it shall be treated as a dividend for federal tax pur-

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preferred stock individually, the proceeds of the redemption would apparently have been taxed to him as a dividend. Section 302, Internal Revenue Code of 1954.

poses. See Section 302(b)(1) (Appendix, *infra*, p. 7).

After analyzing the full context of the transaction in considerable detail, the courts below held that WCAX's purchase of petitioner's Mt. Mansfield preferred stock fell squarely within Section 304 and that WCAX's $27,000 payment to petitioner was essentially equivalent to a dividend. Section 302 of the 1954 Code incorporates much the same standards for determining whether a distribution is essentially equivalent to a dividend as applied under its statutory predecessor, Section 115(g)(1) of the Internal Revenue Code of 1939. See S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 44, 233-237; *Radnitz* v. *United States*, 187 F. Supp. 952 (S.D. N.Y.), affirmed *per curiam*, 294 F. 2d 577 (C.A. 2). The numerous factors which were given consideration by the courts below in determining whether the distribution here was essentially equivalent to a dividend have been spelled out in detail by the various courts of appeals. In emphasizing the net effect of the distribution as the single most important factor for dividend equivalence, the district court and the Second Circuit followed the rule consistently enunciated by the courts of appeals. See, *e.g.*, *Bradbury* v. *Commissioner*, 298 F. 2d 111 (C.A. 1); *Northup* v. *United States*, 240 F. 2d 304 (C.A. 2); *Kessner* v. *Commissioner*, 248 F. 2d 943 (C.A. 3); *Ballenger* v. *United States*, 301 F. 2d 192 (C.A. 4); *United States* v. *Fewell*, 255 F. 2d 496 (C.A. 5); *Bell* v. *Commissioner*, 248 F. 2d 947 (C.A. 6); *Commissioner* v. *Snite*, 177 F. 2d 819 (C.A. 7); *Heman* v. *Commissioner*, 283 F. 2d 227

(C.A. 8); *Pacific Vegetable Oil Corp.* v. *Commissioner*, 251 F. 2d 682 (C.A. 9); *Jones* v. *Griffin*, 216 F. 2d 885 (C.A. 10); and *Flanagan* v. *Helvering*, 116 F. 2d 937 (C.A. D.C.).

Perhaps the best reason for the emphasis which most of the courts of appeals have placed on the distribution's net effect, and their de-emphasis of the purposes for which it was made is the difficulty—if not the impossibility — of distinguishing between "corporate purpose" and "shareholder purpose" in cases where a single shareholder dominates the corporation. *McGinty* v. *Commissioner*, 325 F. 2d 820, 822 (C.A. 2); *Kerr* v. *Commissioner*, 326 F. 2d 225, 230 (C.A. 9), certiorari denied 377 U.S. 963; *United States* v. *Collins*, 300 F. 2d 821, 823 (C.A. 1).

Applying the criteria set forth by these cases, the courts below reached the correct conclusion. Petitioner's control of both Mt. Mansfield and WCAX was unaffected by the transfer; he still owned the 270 shares of Mt. Mansfield through his retained control of WCAX. In economic substance petitioner parted with nothing, and the net effect of the distribution was to transfer $27,000 from WCAX to petitioner, its 98% shareholder. Moreover, the court below correctly concluded that petitioner's alleged business reason for the distribution was entitled to little weight, since petitioner clearly arranged the transaction so that part of WCAX's retained earnings would be distributed when it could have been arranged so as to avoid such a distribution. If petitioner had instead pledged his WCAX or Mt. Mansfield stock and borrowed the money himself, he would

not have obtained a $27,000 distribution from WCAX. Thus, there was no "business purpose" adequate to justify insulating this type of transaction from dividend equivalence tax treatment. (Pet. 14.)

No important question with respect to the application of Sections 302 and 304 is presented here nor is there any substantive disagreement among the courts of appeals requiring resolution by this Court. While some courts of appeals treat the presence of a corporate business purpose as having more weight than do others, the courts are in accord that the ultimate test is one of net effect. Moreover, the difference in emphasis would have made no difference in result here. All of these cases are highly factual in nature, and there is no conflict in decisions justifying further review of this case.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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AUGUST 1965

APPENDIX

Internal Revenue Code of 1954:

SEC. 302. DISTRIBUTIONS IN REDEMPTION OF STOCK.

(a) *General Rule.*—If a corporation redeems its stock (within the meaning of section 317 (b)), and if paragraph (1), (2), (3), or (4) of subsection (b) applies, such redemption shall be treated as a distribution in part or full payment in exchange for the stock.

(b) *Redemptions Treated as Exchanges.*—

(1) *Redemptions not equivalent to dividends.*—Subsection (a) shall apply if the redemption is not essentially equivalent to a dividend.

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(26 U.S.C. 302.)

SEC. 304. REDEMPTION THROUGH USE OF RELATED CORPORATIONS.

(a) *Treatment of Certain Stock Purchases.*—

(1) *Acquisition by related corporation (other than subsidiary).*—For purposes of sections 302 and 303, if—

(A) one or more persons are in control of each of two corporations, and

(B) in return for property, one of the corporations acquires stock in the other corporation from the person (or persons) so in control,

then (unless paragraph (2) applies) such property shall be treated as a distribution

in redemption of the stock of the corporation acquiring such stock. In any such case, the stock so acquired shall be treated as having been transferred by the person from whom acquired, and as having been received by the corporation acquiring it, as a contribution to the capital of such corporation.

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(26 U.S.C. 304.)

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